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TAGS: PREL EFIN ETRD ECON
SUBJECT: DEPUTY SECRETARY'S MEETING WITH BRAZILIAN FINANCE
MINISTER PALOCCI

Classified By: Janice Fair, Economic Officer; Reasons 1.4 (b),
(d)

¶1. October 6, 2005, 5:00 P.M., Finance Ministry, Brasilia,
Brazil.

¶2. Participants:

United States:
The Deputy Secretary
Tom Shannon, Special Assistant to the President and
Senior Advisor for Western Hemisphere Affairs
Ambassador John Danilovich
Phillip Chicola, Deputy Chief of Mission
Christopher Padilla, D Chief of Staff
Janice Fair (notetaker), Econoff

Brazil:

Finance Minister Antonio Palocci
Roberto Abdenur, Brazilian Ambassador to the United States
Joaquim Levy, Treasury Secretary, Ministry of Finance
Luiz Awazu Pereira, Assistant Secretary for International
Affairs
Marcos Galvao, Minister's Chief of Staff
Paulo Chuc, Foreign Ministry America Desk

¶3. (C) Summary. In a cordial one hour meeting on Thursday, October 6, Deputy Secretary Zoellick and Brazilian Finance Minister Palocci discussed a generally positive regional economic scenario, as well as the need to address underlying economic problems that have contributed to political difficulties in some of the region's more fragile democracies. As a means of pre-empting the rise of populist leaders, the Deputy Secretary broached the idea of hemispheric leaders mobilizing the Organization of American States (OAS) and the Inter-American Development Bank (IDB) to implement economic development programs targeting the more marginalized segments of society, thereby generating support for sound economic management and democracy. Palocci identified legal reforms and improvements in the business climate among his priorities for further structural reforms in the Brazilian economy and noted international negotiations could help speed an opening of the reinsurance sector. The Deputy Secretary described the U.S.-Brazil relationship as good, but not developed to its full potential. Both expressed an interest in expanding and deepening the bilateral political and economic dialog. End Summary.

¶4. (C) Minister Palocci gave an upbeat assessment of the economic outlook for Latin America. Brazil has reached solid economic stability through prudent government policies, and enjoys a reduced vulnerability to oil price shocks due to private investment and diversification in energy use -- 68 percent of the autos produced in Brazil can run on ethanol as well as gasoline. The country is now prepared for a period of sustained growth, he added. Palocci noted problems in Bolivia, and to a lesser extent in Ecuador, but praised Chile, Colombia and Uruguay for implementing policies firmly grounded in sound economic principles. Palocci touched briefly on Brazil's economic collaboration with Argentina, conveying confidence in Argentine Economic Minister Lavagna, but noting difficulties in that country due to incomplete reforms, inflationary pressure, and resistance by Argentine industrialists to trade liberalization. Despite good economic policies in a number of countries, Palocci cautioned that economic adjustments in major economies -- such as U.S. Federal Reserve announcements on interest rate changes -- can have substantial impact on the region's emerging markets; he advocated orderly, transparent and coordinated actions to mitigate market disruptions.

¶5. (SBU) In response to an inquiry from the Deputy Secretary regarding the GoB's agenda for structural reforms, Palocci counted among government successes the new bankruptcy law and an expansion of credit instruments. With regard to future initiatives, Palocci explained that the creation of 100,000 jobs per month as a result of economic policy reforms helped convince him that traditional labor reform is not as important as it was once. Instead, he believes the emphasis

should be on legal reforms and other improvements in the general business climate which will have a more profound impact on economic growth and employment. Palocci also said a successful outcome in the WTO Doha trade negotiations is important for advancing economic development throughout the world.

16. (C) Picking up on the trade theme, the Deputy Secretary said he believes Brazil, along with China, could emerge as an industrial power within 10 years, and noted the importance of trade liberalization in the manufacture and services sectors for boosting the competitiveness of an increasingly outward oriented Brazilian industry. Palocci responded that Brazil's financial services sector is open, and added that a bill is in the Brazilian Congress to open the reinsurance sector, currently a government monopoly. He suggested that the process for opening this sector could be accelerated as a result of international negotiations. Speaking more generally, Palocci shared his impression from recent IMF meetings of a more positive climate toward trade among developing countries, but added that although there is increased willingness on the part of developing countries to consider expanded market access for manufactures, the expectation remains that developed countries must make the first move.

17. (C) The Deputy Secretary characterized the U.S.-Brazil relationship as good, but not developed to its full potential, despite the goals we share as the two largest democracies in the western hemisphere. He said part of his motivation for coming to Brazil was to seek a deepening of that relationship and, in particular, to explore working more closely with the GoB on ideas for improving economic and political stability in the region. The Deputy Secretary reasoned that economic problems underlie many of the political difficulties besieging some of the more fragile democracies. He argued that people must see the benefit of economic development policies in their own lives or their dissatisfaction will be exploited by populists, such as Venezuela's Chavez and Nicaragua's Aleman.

18. (C) An idea broached by the Deputy Secretary with Palocci, and raised earlier with Presidential advisor Marco Aurelio Garcia, was to urge the OAS and the IDB to marshal and coordinate their resources and expertise for projects that focus economic development at the individual level. Projects could include micro-lending, property rights for indigenous peoples, mortgage financing -- projects which by producing concrete results for marginalized citizens would help generate support for sound economic management and democracy. The Deputy Secretary suggested that having USG and Brazilian officials compare notes and exchange ideas about the nexus between political and economic issues would be a useful exercise. He noted that since Luis Moreno and Jose Insulza are both relatively new in their positions at the IDB and OAS, respectively, now is an opportune time to approach them on reassessing the kind of economic assistance that would be most useful for bolstering democracy in the regions' less stable countries.

19. (C) Palocci agreed that populism is a problem in Latin America, noting the importance of governments such as Brazil's, Chile's and Uruguay's in demonstrating that "left" does not equate with populist or unsound economic policies. Without endorsing the specific idea regarding the OAS and IDB, Palocci supported expanding the USG-GoB political and economic dialog and thought that Marco Aurelio Garcia would as well. He praised the bilateral Group for Growth initiative, launched as a result of the 2003 summit between Presidents Bush and Lula, for providing a mechanism for substantive exchanges between our economic teams; he thought the model could be adopted for discussions of other issues as well. Palocci indicated an interest in encouraging the IDB to support countries pursuing public-private partnerships by helping with evaluation of projects and contracts. The Deputy Secretary took the point further and suggested the time is ripe for development banks to reassess their mission, focusing more on improving access to information on a wide range of issue areas and facilitating implementation of economic development policies.

110. This cable was cleared by the Deputy Secretary's traveling party.

Danilovich